Approaching Shortfall Could Limit Highway Payments to the States

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The impact of the Coronavirus Disease 2019 (COVID-19) pandemic on highway tax revenues is leading the Federal Highway Administration (FHWA) to alter procedures for reimbursing the states for highway construction expenditures. If the new procedures take effect, most states could experience both delays and reductions in the federal reimbursements they receive for highway work they have completed. Unless Congress acts to provide more money before then, FHWA could reduce payments to the states as early as October 12, 2021.

Almost all the funding to support the Federal-Aid Highway Program comes from the highway account of the Highway Trust Fund (HTF). HTF revenue derives mainly from taxation of motor vehicle gasoline and diesel. Since the early 2000s, revenue from these sources has been less than outlays from the HTF. Consequently, Congress has periodically transferred money to the HTF, mostly from the Treasury general fund. Upon passage of the last authorization extension, the expectation was that such transfers would be sufficient to keep the HTF solvent into the summer of FY2022.

However, in part because of the impact of the COVID-19 pandemic on motor fuel tax revenues, FHWA now anticipates the highway account will run out of money in November if new cash management procedures are not implemented first. On August 26, 2021, FHWA released a guidance memorandum outlining the procedures it intends to put in place. The procedures would apply only to the highway account, not to the separate mass transit account within the HTF, which does not face a near-term shortfall.

Federal highway programs operate on a reimbursable basis: a state government expends the money as approved by federal officials, and then applies for the federal payment. Reimbursement normally occurs within 24 hours of the request via electronic funds transfer. However, the Anti-Deficiency Act prohibits the HTF from having a negative balance. To avoid this problem, when the balance in the highway account approaches $4 billion, which FHWA considers the minimum working balance, FHWA must implement some way of reducing or slowing payments. This means that states may have to wait for full reimbursement of funds they have already expended.

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Implementation

According to FHWA, the cash management procedures would work as follows. As soon as early October 2021, FHWA would no longer reimburse the states in full as soon as they submit vouchers. Instead, the day after the Treasury makes one of its twice-monthly deposits into the HTF, FHWA will allocate the cash to the states in proportion to each state's share of the total nationwide unexpended obligated balances as of September 30, 2021. This, in effect, places a cap on payments that would be made to each state until the next semimonthly deposit into the HTF. If a state does not use all of its allocation in the semimonthly period, the unused balance would be added to its allocation for the next period.

FHWA has provided the following example:

> Total cash available to all states (from the semi-monthly distribution) = $1.4 billion
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> State's allocation share = 1.6%
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> State's current period allocation = $22.4 million (1.6% of $1.4 billion)
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> State's carry-over from prior period = $2.0 million
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> **Total amount available to state = $24.4 million**

The FHWA district office in each state would determine which reimbursements to approve up to the state's cap. Requests for reimbursement in excess of the cap would remain unapproved but could be considered in later payment cycles. The requested payment date must be at least three days after the date of the request for payment.

These delays of reimbursement are for activities for which the federal government is legally obligated to pay. Delayed payment means that the states would in effect be lending money to the federal government. The federal government would have to pay interest to the states on the amounts it owes them according to 31 C.F.R. 205.14. Nonetheless, slowing federal payments would affect the states' cash flow. Some states might have to borrow money or use other state funds to pay their contractors, or might delay payment to contractors on jobs for which the state has not yet requested federal reimbursement. Over time, this could lead to delays in project completion, the start of approved new projects, new project planning, and calls for bids on new projects.

To prevent delays and reductions of reimbursement to the states, Congress could pass a multiyear reauthorization act, such as the Senate-passed Infrastructure Investment and Jobs Act (H.R. 3684), which would extend transfers from the general fund to the HTF through FY2026. Alternatively, it could pass a second short-term extension of the Fixing America's Surface Transportation Act (P.L. 114-94; FAST Act), also including a general fund transfer, to keep the HTF solvent.

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